

ALLEN & OVERY

Directors' duties and liabilities in financial distress during Covid-19

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A global perspective

Uncertain times give rise to many questions

The Covid-19 pandemic and the ensuing economic crisis has a significant impact, both financial and otherwise, on companies around the world. Boards are struggling to ensure survival in the short term and preserve cash, whilst planning for the future, in a world full of uncertainties.

Many directors are uncertain about their responsibilities and the liability risks in these circumstances. They are facing questions such as:

- If the company has limited financial means, is it allowed to pay critical suppliers and leave other creditors as yet unpaid? Are there personal liability risks for 'creditor stretching'?
- Can you enter into new contracts if it is increasingly uncertain that the company will be able to meet its obligations?
- Can directors be held liable as 'shadow directors' by influencing the policy of subsidiaries in other jurisdictions?
- What is the 'tipping point' where the board must let creditor interest take precedence over creating and preserving shareholder value?
- What happens to intragroup receivables subordinated in the face of financial difficulties?
- At what stage must the board consult its shareholders in case of financial distress and does it have a duty to file for insolvency protection?
- Do special laws apply in the face of Covid-19 that suspend, mitigate or, to the contrary, aggravate directors' duties and liability risks?



There are more jurisdictions involved than you think

Most directors are generally aware of their duties under the governing laws of the country from which the company is run. However, individuals may also be directors of subsidiaries in other jurisdictions, either personally or indirectly through holding or management entities of which they are directors. And even if they are not, the laws that govern the subsidiaries may classify them as shadow directors of the subsidiary. All this may expose directors to duties and liability risks at local levels.

To complicate matters, liability may not only arise under local company law, but also under tort laws of countries where contracts are entered into that later cannot be performed, causing damages to the company's counterparties. Insolvency proceedings may be opened in yet more jurisdictions where the company or its subsidiaries do business and local insolvency laws may contain specific directors' duties and liability regimes.

Guidance to navigating these risks

We have put together an overview of the main issues facing directors in financially uncertain times in a number of key jurisdictions across the globe. This includes a brief general description of directors' duties and key areas of potential directors' liability in each country, as well as some answers to the questions listed above.

Obviously, the duties and liabilities that may arise will always be dependent on the circumstances. Therefore, this publication should not be used as legal advice when faced with a specific dilemma. However, we hope it may help to alert directors and their in-house advisors to the duties, pitfalls and liability risks that exist in major jurisdictions across the globe.



Spain

No.	Question	Answer
Directors' Duties		
1.	Do directors have to act primarily in the interest of their shareholders or do they have to take in account other stakeholders' interests as well? Does that regime change in case of financial distress?	Under Spanish company law, directors shall act in good faith, with loyalty and solely in the company's best interest under the principle of personal responsibility, with freedom of criteria or judgement and independence with respect to instructions and third parties. Notwithstanding the foregoing, the statutory provisions set out the possibility that instructions to the management body are given through a General Shareholders' Meeting decision or that certain management decisions or resolutions are subject to the authorisation of the General Shareholders' Meeting. Such duties do not change in the event of financial distress.



No.	Question	Answer
2.	What are the key areas of potential liability for directors when a company is in financial difficulties?	<p>In Spain, all directors should act as responsible businessmen. Directors must always act in the best interest of the company. These duties of care and loyalty to the company do not change, even in a situation of distress. Therefore, and without prejudice to the insolvency liability explained below, the directors of a company are subject to common corporate liability and will be liable towards the company, its shareholders or third parties by their acts or omissions which are contrary to law, the articles of association of the company, or by any act performed or omitted in breach of the duties arising from their position.</p> <p>As a matter of Spanish Corporate Law, directors have two main duties: (1) the duty of diligence requires that a director must perform their role and comply with the duties imposed by the laws and the articles of association, acting with the diligence of a proper businessman (<i>ordenado empresario</i>), taking into account the nature of their office and the duties entrusted to them, and (2) the duty of loyalty implies that directors shall perform their duties with the loyalty of a loyal representative, acting in good faith and in the company's best interest. Additionally, directors must also avoid acting in circumstances where their own interests may be in conflict with the corporate interest and with their duties towards the company.</p> <p>Broadly speaking, under Spanish law we would differentiate the following main liability areas:</p> <ol style="list-style-type: none"> Corporate offences: Directors (current and previous, as well as <i>de jure</i> and shadow directors) may be liable for certain corporate offences relating to failure to provide the requisite level of supervision, monitoring and control of the company's activities. People that collaborated with the director in the commission of those offences or have directly induced the commission of those offences may also face liability. Insolvency obligations: Directors may also face liability if they fail to commence insolvency proceedings at the appropriate time (as required by law) or fail to notify the court of the initiation of negotiations with creditors to reach a refinancing agreement or obtain sufficient approval for an early composition when a company is not able to meet its payment obligations. The main focus in this area is whether directors caused or aggravated the company's insolvency. If that were the case, directors may have to bear any or part of the shortfall in the company's debts after completion of the liquidation. Tax infringements: Directors may be held liable for the company's: (i) tax infringements (including penalties); (ii) outstanding tax debts (excluding penalties); (iii) tax debts derived from taxes that must be levied on, or amounts that must be withheld from, employees, professionals or other businessmen in certain circumstances. Other legislation: Directors may also be liable for actions or omissions under other specific legislation such as: competition legislation, consumer, criminal, environmental and user protection laws. We refer in particular to the summary of environmental liabilities set out on the following page.
3.	Does a director's liability rest only with formally appointed managing directors, or also with others who perform managerial tasks?	<p>Liability rests with both formally appointed and <i>de facto</i> directors and accomplices. As a matter of Spanish corporate law, <i>de facto</i> directors are those persons who perform the tasks and role of director without the title, or with a null or void title, or with another title. Pursuant to Spanish insolvency law, accomplices are those persons who, with either malicious intent or gross negligence, have aided directors in the performance of any managerial tasks that are considered to infringe the laws of the company's articles of incorporation.</p>



No.	Question	Answer
4.	What are the liability risks for directors if the company borrows new money or enters into new contracts but may not be able to perform the ensuing obligations?	Pursuant to Spanish insolvency law, the directors of a company are liable when they perform acts that have caused or aggravated the insolvency of the company and such insolvency is classified as tortious, triggering the possible pronouncements against directors as indicated above. In this regard, there is a risk that borrowing new money or the execution of new contracts may imply that the insolvency is classified as tortious by the insolvency judge, assuming that the directors had performed such acts with malicious intent or gross negligence and, in particular, in the knowledge that the company would be unable to assume its contractual obligations under such agreements in the future, leading to an aggravation of the insolvency situation. In any case, it is a situation that must be analysed on a case-by-case basis, with the burden of proof on the party asserting that such acts have aggravated the insolvency.
5.	What are the liability risks in case of 'creditor stretching'?	The mere fact that directors of a company do not ensure that the company complies with its (payment) obligations towards its creditors is not in itself enough to establish personal liability. In general, directors of the company are liable for the damage caused to any creditor by their acts or omissions which are contrary to the law, the articles of association or having failed to complete any duties inherent to their roles. Although directors will not generally be liable for 'creditor stretching', each scenario should be analysed in detail given the particular circumstances.
6.	What are the liability risks in case of selective payments to some but not all creditors in case of liquidity issues? Is there a stage at which directors must treat all creditors equally?	Notwithstanding the general liability regime briefly explained in question 2 above, directors are not generally liable for selecting payments to some but not all creditors in case of liquidity issues. On the other hand, all creditors will be treated equally once the insolvency judge initiates the insolvency proceedings. However, acts that are detrimental to the company's insolvency estate (<i>patrimonio</i>) which are performed by the company within the two years prior to the date of the insolvency declaration may be revoked by means of a claw-back action, even though there may not have been a fraudulent intention.
7.	Is there a distinction in this regard between preferential treatment of related entities and the treatment of other creditors?	There is not a specific distinction between preferential treatment of related entities and the treatment of other creditors. However, the insolvency shall be considered tortious (as explained above) when, among others, properties, goods or rights have fraudulently been detracted from the debtor's assets during the two years prior to the date on which insolvency proceedings are initiated.



No.	Question	Answer
8.	Is there an obligation in case of financial difficulties to convene a shareholders meeting and if so, at what stage of financial difficulties?	No, unless there are specific provisions in the articles of association to that effect.
9.	Is there an obligation at some stage to file for bankruptcy or other statutory insolvency protection regimes?	The company shall petition for a declaration opening the insolvency proceedings within two months following the date on which it became aware, or should have been aware, of its insolvency status. Pursuant to Spanish insolvency law, a company is insolvent when it cannot duly meet its payment obligations when due. In the event that directors fail to comply with their duty to file for the insolvency of the company within the statutory term provided, among others, they may be eventually subject to personal liability to cover all or part of the shortfall of creditors after the liquidation of the debtor's assets or disqualified from managing businesses for a term between 2 to 15 years in case such delay is deemed to have caused or aggravated the company's insolvency position. However, due to recent Covid regulations, directors would not be under an obligation to call for insolvency until 31 December 2020.
10.	Are there special liability risks in respect of certain debts, such as tax debts, social security payments, and pension contributions?	Yes, directors are jointly and severally liable for tax debts, criminal liabilities or tort arising from crime (including principal debt, surcharges, interest and penalties) under certain circumstances (e.g. when causing or actively cooperating in the commission of a breach or crime, or where they fail to comply with the obligation to apply for insolvency proceedings) and incur subsidiary liability for such debts when they have generally failed to perform the acts necessary to comply with such obligations. Regarding social security payments and contributions, directors may be jointly and severally liable for the principal debt, surcharges and interest accrued, and costs incurred in the collection of the debt (but excluding penalties).
11.	Are the liability risks of the directors collective (the whole board is responsible/liable) or individual? On what grounds can a director exculpate themselves from other directors' acts or omissions?	According to Spanish company law, all members of the governing body adopting the harmful decision or performing the respective act are jointly and severally liable, unless they prove that they have not taken part in its adoption or implementation, were unaware of its existence or, if aware, took all reasonable measures to prevent the damage or, at least, were expressly opposed to it.



No.	Question	Answer
12.	Are there specific actions against directors under bankruptcy law?	Yes, as explained in questions 2 and 4 above, directors are liable when they perform acts that have caused or aggravated the insolvency of the company and such insolvency is classified as tortious. Any creditor or person who provides evidence of a legitimate interest may appear before the insolvency judge and be a party, alleging in writing whatever he considers relevant for the classification of the insolvency as tortious (although the insolvency administrator and the public prosecutor would be the ones leading this accusation process).
13.	Are there specific duties of (or consequences for) shareholders or other group companies at some stage of the financial difficulties, such as an automatic subordination or conversion into equity of debt to parent companies?	Financial difficulties as such do not trigger additional duties of (or consequences for) shareholders or group companies.
14.	Is there special legislation mitigating the liability risks of directors specifically in view of the Covid-19 crisis?	There is no special legislation mitigating the liability risks of directors specifically in view of the Covid-19 crisis (although, as previously noted, the duty to file for insolvency has been postponed).



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